Impact Summary: GST on telecommunications services

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment (RIA), except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing key policy decisions to be taken by or on behalf of Cabinet.

Key Limitations or Constraints on Analysis
An assumption has been made that applying GST or VAT to outbound mobile roaming services is more likely to become the common approach worldwide. This assumption is based on the OECD finalising in 2017 its *International VAT/GST Guidelines* (*the Guidelines*) which set forth internationally agreed standards for the GST/VAT treatment of international transactions and the European Union applying VAT to outbound roaming services received by its residents. Under the *Guidelines,* remote services (which includes telecommunications services) should generally be subject to GST/VAT in the country that the recipient of the services is normally resident.
Quality Assurance Reviewing Agency:
Inland Revenue
Quality Assurance Assessment:
The Quality Assurance reviewer at Inland Revenue has reviewed the *GST on telecommunications services* regulatory impact assessment prepared by Inland Revenue and considers that the information and analysis summarised in it **meets** the quality assurance criteria.
Reviewer Comments and Recommendations:
The reviewer's comments on earlier versions of this RIA have been incorporated into this version.
Responsible Manager (signature and date):
Graeme Morrison Policy Lead Policy and Strategy Inland Revenue 23 October 2019

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Under New Zealand's current GST rules for telecommunications services both outbound mobile roaming services received by New Zealand residents travelling overseas and inbound mobile roaming services received by non-residents in New Zealand are not subject to GST (or are subject to GST at the rate of 0%).[1]

The current rules are inconsistent with New Zealand's broad-based GST framework, under which one of outbound or inbound mobile roaming services should be subject to GST.

As GST is intended to be a tax on final consumption, applying GST to either outbound or inbound mobile roaming services received by GST registered businesses should not have a net revenue benefit. Businesses receiving roaming services should (if GST-registered and using the services for making taxable supplies) be able to claim back the GST incurred on these services as an input tax deduction. The net revenue benefit from applying GST to either outbound or inbound mobile roaming services should therefore only be the GST incurred by final consumers.

The OECD released *International VAT/GST Guidelines* in 2017. Under these Guidelines remote services (including telecommunications services) should generally be subject to GST or VAT in the jurisdiction where the recipient of the service is normally resident. Remote services are services in which there is no necessary connection between the place of performance of the services and the location of the recipient of the services.

In light of the OECD's Guidelines, the European Union (EU) and the United Kingdom (UK) have begun applying VAT to outbound mobile roaming services received by their residents travelling overseas.

However, in over 80 other jurisdictions (including Canada, Japan and Singapore) GST, VAT or a local sales tax is added to inbound mobile roaming services, generally by applying these taxes to the wholesale roaming services supplied by local telecommunications suppliers to foreign telecommunications suppliers to enable the supply of inbound mobile roaming services. The GST/VAT rules for telecommunications services in most of these jurisdictions pre-date the OECD finalising its *International VAT/GST Guidelines*. It is unclear whether these countries have made a considered decision to maintain their pre-existing rules for telecommunications services or if they have simply not reviewed these rules yet in light of the OECD's *Guidelines*.

Like New Zealand's current rules, Australia does not apply GST to either outbound or inbound mobile roaming services.

The differing treatment of mobile roaming services around the world can result in both double taxation and double non-taxation. For example, the roaming services received by an EU resident travelling in Canada would be subject to GST/VAT in both the EU and Canada. Conversely, the roaming services received by a Canadian resident in the EU would not be

[1] Inbound mobile roaming services may, in certain circumstances, be subject to GST but these circumstances rarely arise.

subject to GST/VAT in either jurisdiction.

On 8 April 2019 Cabinet agreed as part of Budget 2019 to amend the GST rules for telecommunications services to apply GST to outbound mobile roaming services from 1 October 2020 (refer *DEV-19-MIN-0059*). The issues paper *GST and telecommunications services* was then released on 17 May 2019 to consult on the detailed design of the proposed changes.

This RIA updates the analysis of options following consultation on the issues paper. However, the proposed option is still to apply GST to outbound mobile roaming services.

Application date

Cabinet has previously agreed to an application date for the proposed changes to the GST rules for telecommunications services of 1 October 2020. However, this application date may not give telecommunications suppliers enough time to make and test the necessary systems changes to apply GST to outbound mobile roaming services.

2.2 Who is affected and how?

The affected parties are suppliers of telecommunications services and the consumers of these services. New Zealand telecommunications suppliers will be affected as the proposed options would impact on the GST treatment of their supplies of outbound mobile roaming services. Consumers of telecommunications services will be affected as the price they pay for mobile roaming services may increase depending on whether suppliers pass on the full GST cost, or alter their pricing strategies.

2.3 Are there any constraints on the scope for decision making?

Applying GST to the actual inbound mobile roaming services supplied by foreign telecommunications suppliers to non-residents travelling in New Zealand is unlikely to be a viable option and has therefore not been considered. Many telecommunications suppliers sell global or regional roaming packs that allow a consumer to roam in multiple jurisdictions for a single fee. At the time of supply the telecommunication supplier will not know which jurisdiction a consumer will consume the roaming services in. Furthermore, a consumer may consume the roaming services in multiple jurisdictions. If the actual inbound roaming services were subject to GST it would therefore be likely to cause telecommunications suppliers significant difficulties in attempting to apportion roaming charges between the different jurisdictions in which a customer consumed the roaming service.

Section 3: Options identification

3.1 What options have been considered?

The objective is to maintain New Zealand's broad-based GST framework by extending the application of GST to more services. The following criteria have been used to assess the options against this objective:

- Destination principle: The option should be consistent with the principle that GST or VAT should generally apply in the jurisdiction in which consumption occurs.
- Business neutrality: The option should be consistent with the principle that GST should be borne by final consumers and should not be a cost to businesses.
- International consistency: The option should give consideration to approaches taken internationally to minimise instances of double taxation or double non-taxation.
- Compliance costs – The option should minimise compliance costs for telecommunications suppliers as much as possible.

Option 1: Status quo

Under the status quo both outbound and inbound roaming services are not subject to GST at 15%.

The status quo does not achieve the objective as, under New Zealand's broad-based GST framework, GST should apply to one of outbound or inbound mobile roaming services.

Option 2: Apply GST at 15% to outbound mobile roaming services (proposed option)

Under this option, outbound mobile roaming services received by New Zealand residents travelling overseas would become subject to GST at the standard rate of 15%.

The gross GST that would be collected under this option is estimated to be $12.993 million per annum. However, GST registered businesses paying GST on the outbound mobile roaming services they receive would be able to claim back this GST as an input tax deduction. It is therefore estimated that this option would increase net GST revenue by $7.041 million per annum.

<u>Analysis of option</u>

This option would be consistent with the objective of maintaining New Zealand's broad-based GST framework as it would add GST to the entire outbound mobile roaming services received by New Zealand residents travelling overseas.

Applying GST to outbound mobile roaming services is not consistent with the destination principle as to receive mobile roaming services a New Zealand resident must be outside New Zealand. However, there are circumstances in which it is appropriate to depart from the destination principle. The OECD's *Guidelines* recommend using a consumer's usual place of residence for determining which jurisdiction's GST or VAT applies to a supply of remote services (including telecommunications services) regardless of the physical location of the consumer. For example, if a New Zealand resident downloads a movie while on holiday in Australia, New Zealand GST should apply to the download of the movie. This departure from the destination principle is considered appropriate as often the supplier of a remote service will not know the actual location of the consumer and therefore the consumer's residency is considered an appropriate proxy for the most likely place of consumption of remote services.

This option would be consistent with the principle of business neutrality as GST-registered business can claim back the GST they incur as an input tax deduction.

This option would be consistent with rules in the European Union and the United Kingdom which apply VAT to outbound mobile roaming services received by their residents.

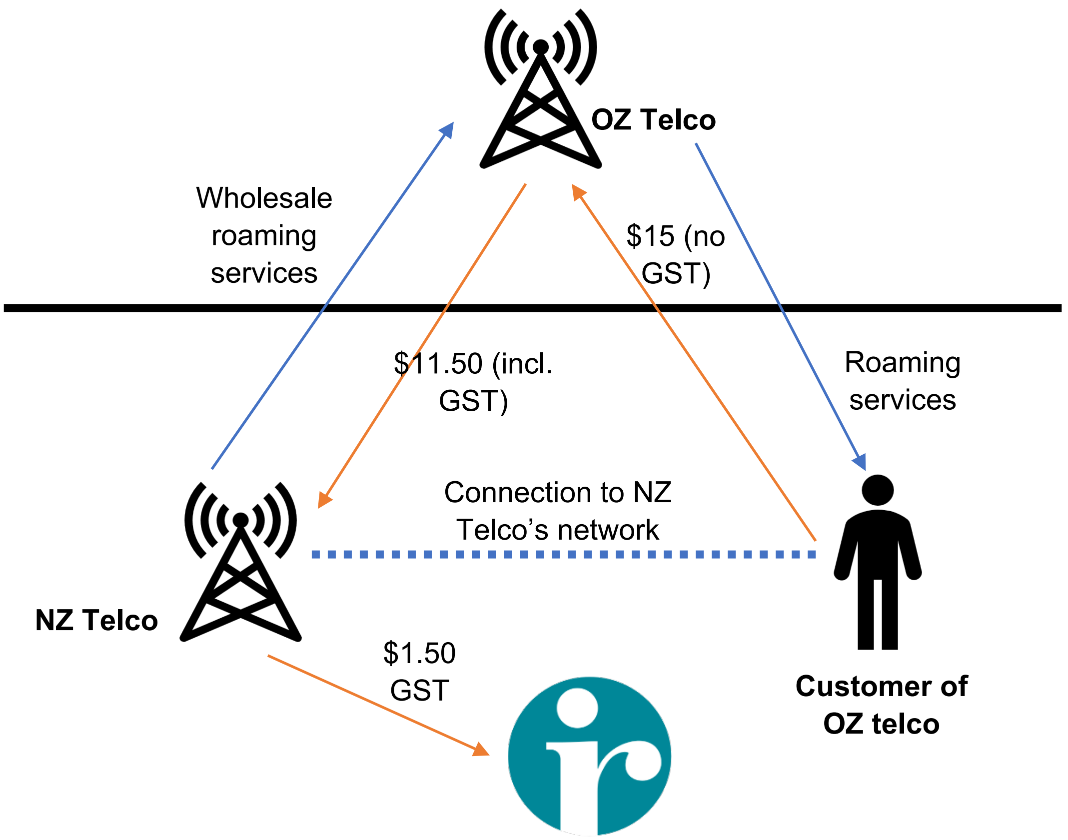
However, this option would be inconsistent with the approach taken in over 80 other jurisdictions which add GST, VAT or a local sales tax to inbound mobile roaming services, generally by applying GST to wholesale mobile roaming services. However, the rules in many of these jurisdictions pre-date the OECD finalising its *International VAT/GST Guidelines.*

The option would also be inconsistent with Australia which, like New Zealand's current rules, does not apply GST to either outbound or inbound roaming services.

The telecommunications industry has estimated that this option would impose on the industry compliance costs associated with updating their billing systems of approximately $1 million. They would also incur costs associated with notifying their customers of the change in the GST treatment of outbound roaming services. The compliance costs for this option would be a one-off cost and on-going compliance costs would be comparable to the status quo.

Option 3: Apply GST to inbound wholesale mobile roaming services

GST could be added to inbound roaming by applying GST to the wholesale mobile roaming services supplied by New Zealand telecommunications suppliers to foreign telecommunications suppliers to enable the foreign telecommunications suppliers' customers to roam in New Zealand. This would result in unrecoverable GST being embedded in the price of roaming services received by non-residents travelling in New Zealand. The diagram on the following page illustrates how applying GST to wholesale roaming charges would work.



As can be seen in the above diagram, applying GST to the wholesale roaming charges would add GST on to the services NZ Telco supplies to OZ Telco to allow OZ Telco's customers to roam in New Zealand. There is no GST on the actual supply of roaming to OZ Telco's customer. However, GST is embedded in the price of the roaming services received by OZ Telco's customer as OZ Telco is unable to claim an input tax deduction for the GST they paid to NZ Telco.

It is estimated that this option would increase GST revenue by $3.8 million per annum. As GST would be imposed on the wholesale roaming services rather than the actual inbound mobile roaming services, non-resident businesses consuming inbound mobile roaming services in New Zealand would not be able to claim back the GST embedded in the price of these services. As such, there is no need to consider the difference between gross and net GST revenue under this option.

<u>Analysis of option</u>

This option partially achieves the objective of maintaining New Zealand's broad-based GST system as it would add GST to the price of inbound roaming services received by non-residents travelling in New Zealand. However, the margins charged by the suppliers of inbound roaming services would remain untaxed.

This option would be consistent with the destination principle.

Applying GST to wholesale roaming services is inconsistent with the principle of business neutrality as it would add unrecoverable GST to the price of inbound roaming services received by non-resident businesses in New Zealand.

This option is inconsistent with the approach taken in the European Union and United

Kingdom. However, it would be consistent with the approach taken in over 80 other jurisdictions which apply GST or VAT to wholesale roaming services. Like option 2, this option is also inconsistent with the approach taken to mobile roaming services in Australia.

The telecommunications industry has not quantified the cost of making systems changes to add GST to wholesale mobile roaming services. However, the industry considers that these costs would not be insignificant. Officials consider that the costs of making systems changes for this option may be similar to the costs of making systems changes for option 2. This option would also impose costs on the New Zealand telecommunications industry related to reviewing and potentially re-negotiating their contracts with foreign telecommunications suppliers. As with option 2, the compliance costs of this option would be one-off costs and on-going compliance costs would be comparable to the status quo.

Application date

An application date of 1 October 2020 was originally proposed for the proposed changes to the GST rules for telecommunications services. However, it is proposed to delay this application date by six months to 1 April 2021.

The bill containing the changes to the GST rules for telecommunications services is scheduled for introduction in March 2020. This would mean that there may be little or no time between the legislation being enacted and the original application date of 1 October 2020. If the bill is not passed before the next general election, enactment might not occur until after 1 October 2020.

A very short time period between the bill being enacted and the application date may not give the telecommunications industry sufficient time to make the necessary systems changes to apply GST to outbound mobile roaming services. The billing systems of telecommunications suppliers are complex as they need to operate in real time to ensure a person is correctly charged as they use the network. As such, while changing outbound mobile roaming services from a zero-rated supply to a standard rated supply is itself a simple change, the telecommunications suppliers would need to do extensive testing to ensure the change does not cause any issues for their billing systems.

Given, the factors discussed above, delaying the application date by six months to 1 April 2021 is considered appropriate.

Delaying the application date by six months would have a fiscal cost of $3.52 million.

3.2 Which of these options is the proposed approach?
The proposed approach is to apply GST at the standard rate of 15% to outbound mobile roaming services received by New Zealand residents travelling overseas from 1 April 2021 (option 2 with a six-month delay to the application date previously agreed by Cabinet). While applying GST to outbound mobile roaming services is less consistent with the destination principle than the status quo, it best achieves the objective of maintaining New Zealand's broad-based GST framework and is more consistent with the principle of business neutrality than applying GST to wholesale roaming services. Furthermore, while there is no clear international consensus at this stage, officials consider that, in light of the OECD's *International VAT/GST Guidelines* and the approach taken by the European Union, applying GST to outbound roaming services is more likely to become the common approach worldwide. The proposed approach is aligned with the Government's expectations for the design of regulatory systems.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties	Comment:	Impact
Additional costs of proposed approach, compared to taking no action		
Regulated parties (suppliers)	One-off compliance costs in complying with the change in GST treatment of telecommunications services.	Approximately $1 million
Regulators (Inland Revenue)	Administration costs of proposed approach are comparable to the status quo.	Low
Wider government	Fiscal cost from delaying application date by six months	$3.52 million
Other parties (consumers)	Potential increase in the costs of outbound roaming services supplied to New Zealand residents whilst outside New Zealand. Whether the costs of roaming increase depends on whether and to what extent suppliers pass the GST cost onto consumers or alter their pricing strategies.	Up to $7.041m per annum if suppliers increase their roaming prices to fully recover the GST. This cost would be spread across New Zealand residents who travel overseas each year
Total Monetised Cost		$7.041m per annum (on-going) $4.52 million one-off cost
Non-monetised costs		*Low*

Expected benefits of proposed approach, compared to taking no action		
Regulated parties (suppliers)	Extra six months to make the required systems changes	Low
Regulators (Inland Revenue)	None	None
Wider government	Increase in GST revenue. Applying GST to outbound mobile roaming services helps to maintain the broad-based framework which underpins New Zealand's GST system.	$7.041 million per annum Low
Other parties (consumers)	Reduced GST payments from six-month delay in application date	$3.52 million
Total Monetised Benefit		$7.041 million per annum $3.52 million one-off benefit
Non-monetised benefits		*Low*

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4.2 What other impacts is this approach likely to have?
We do not anticipate the proposed approach would have any other impacts. We will consult with tax advisors and the telecommunications industry on how best to draft the changes to the GST Act to ensure there are no unintended impacts. The select committee process will also be used to ensure there are no unintended impacts.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

The issues paper *GST on telecommunications services* was released on 17 May 2019 to consult on the technical details of the proposal to apply GST to outbound mobile roaming services. Submissions closed on 28 June and in total 6 submissions were received. Following the close of submissions officials conducted further consultation with representatives of the telecommunications industry.

Support for the proposal

Two submissions from accounting firms expressed support for the proposal as they consider it consistent with the OECD's *International VAT/GST Guidelines*. However, one of these submissions expressed concerned that the benefits of the proposal would be outweighed by the compliance costs.

Opposition to the proposal

Four submissions, including one made on behalf of the telecommunications industry, were strongly opposed to the proposal to add GST to outbound roaming services. In further consultation with the telecommunications industry they have regularly expressed their opposition to the proposal.

The key argument raised in opposition to the proposal was that, as outbound roaming services can only be consumed outside New Zealand, it would be contrary to the destination principle to apply New Zealand GST to outbound roaming services received by New Zealand residents overseas. Under the destination principle, GST should generally apply in the jurisdiction in which consumption occurs.

In arguing that it is inappropriate to apply GST to outbound roaming some submitters also argued that roaming services are on-the-spot services and not remote services as a consumer needs to be in the vicinity of a cell tower to receive the service. In arguing that roaming services are on-the-spot services these submitters were arguing that it would be inappropriate to use a consumer's usual place of residence to determine which jurisdiction's GST or VAT applied to a supply of roaming services. However, roaming services should not be considered on-the-spot services as they are not physically performed at a readily identifiable place,[2] and do not require the physical presence of both the person performing the service and the person consuming the service.

The New Zealand telecommunications industry's strong preference is for the status quo to be

[2] Telecommunications services tend to have multiple places of performance and it is difficult to identify a single place of performance. The GST rules for telecommunications services were introduced to address this issue.

maintained. They note that while it is not a conceptually pure option, the existing rules for telecommunications services have been working well and the consider the status quo to be less of a compromise on a conceptually pure GST system than the proposed option. Furthermore, they do not consider that the increase in GST revenue of $7.041 million per annum would justify the one-off compliance costs of approximately $1 million from making changes to their billing systems.

Application date

The telecommunications industry suggested a delayed application date would be appropriate given the time required to make and test systems changes. They are therefore likely to welcome the delayed application date of 1 April 2021.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

Following Cabinet approval, the necessary amendments to the Goods and Services Tax Act 1985 will be included in an omnibus tax bill currently scheduled for introduction in March 2020. The proposals are intended to apply to supplies of telecommunications services from 1 April 2021.

Inland Revenue will be responsible for the on-going administration of the new arrangements. Inland Revenue officials have assessed the magnitude of these administrative impacts and consider that they would be comparable to the status quo.

Guidance on how the proposed approach would work would be provided in bill commentary published at introduction of the legislation and a Tax Information Bulletin published after enactment.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Inland Revenue will monitor the outcomes to confirm that they match the policy objectives.

Officials from Inland Revenue expect that, once the proposals are enacted, affected telecommunications suppliers and their tax advisors will raise with them any concerns they have with how the rules are working in practice. Any necessary changes identified as a result would be recommended for addition to the Government's tax policy work programme.

7.2 When and how will the new arrangements be reviewed?

The review will be the monitoring described in section 7.1 above.